

Taxpayer Ruling LR96-006

May 6, 1996

The following private taxpayer ruling is in response to your letter dated February 5, 1996, (copy attached) on behalf of In your request you ask for a private taxpayer ruling on the application of the use tax to vehicles used at the ... in ..., Arizona. As was stated in the interim letter, this private taxpayer ruling is limited to those classifications of vehicles where there may be some question of taxability. The ruling does not address the ten classifications which clearly fall within the use tax exemption for motor vehicles used in any manner for testing or development and the tax treatment is clear in the law.

The following is a restatement of the facts in your letter.

Statement of Facts:

... .. operates a research and test facility at the ... in ..., Arizona. ... vehicles, manufactured outside Arizona, are brought into the State for use at the Occasionally vehicles may be brought into the state for uses not associated with the company owned vehicle inventory and expensed vehicle accounting systems maintain 43 classifications of vehicles which have not been sold. Each unsold vehicle is assigned to one of the 43 classifications. Most of these classifications can be encountered at some time in Arizona.

... purchases parts for vehicles locally. ... proposes that it purchase all parts pursuant to a claim for exemption for test vehicles. ... will provide vendors with a section 42-1316 exemption certificate (1316 certificate) which cross references the purchase orders, and will mark all purchase orders for parts "tax exempt". At the time ... pulls a part from inventory for use in a vehicle, it will account for the part as taxable or tax exempt on the basis of the current classification of the vehicle in which the part is installed. If the vehicle at that time is assigned to a taxable class, ... will remit use tax on the purchase price of the part. If the vehicle is assigned to a tax exempt class, ... will treat the part as tax exempt.

Your position:

1. The tax applications assigned by ... to each of its accounting system classifications are correct.
2. ... may purchase all vehicle parts from local vendors tax exempt pursuant to a claim of tax exemption for test vehicles by issuing a 1316 certificate. ... may remit use tax on the purchase price of any part which is ultimately used in a vehicle having a taxable status.

Issues:

1. Do the tax applications assigned by ... to each of the accounting system classifications accurately reflect the use tax liability?
2. May ... purchase parts for vehicles tax exempt from local vendors and determine the tax status of the part at the time the part is taken from inventory and installed in a vehicle?

Applicable statutory provisions:

A.R.S. § 42-1408 levies a use tax on the storage, use or consumption of tangible personal property purchased from a retailer. Arizona's use tax rate is five percent.

Arizona Revised Statutes (A.R.S.) § 42-1408.03 provides that motor vehicles and component parts used in any manner for testing or development by motor vehicle manufacturers are exempt from use tax.

A.R.S. § 42-1310.01 imposes the transaction privilege tax on the business of selling tangible personal property at retail. A.R.S. § 42-1310.01(P)(3) defines "selling at retail" as a sale for any purpose other than for resale in the regular course of business. All sales of tangible personal property are subject to tax unless specifically exempted by statute.

A.R.S §§ 42-1310.01(B)(14) and 42-1409(B)(14) provide exemptions under the retail classification and the use tax for sales or purchases of machinery or equipment used in research and development.

Discussion:

Arizona imposes a transaction privilege tax which differs from the sales tax imposed by most states. The Arizona transaction privilege tax is a tax imposed on the privilege of conducting business in the State of Arizona. This tax is levied on the vendor, not the purchaser. The vendor may pass the burden of the tax on to the purchaser; however, the vendor is ultimately liable to Arizona for the tax.

In addition to the transaction privilege tax, Arizona levies a use tax on the storage, use or consumption of tangible personal property purchased from a retailer. The use tax applies when making purchases from out-of-state retailers that do not have transaction privilege tax nexus. Use tax also applies to purchases of tangible personal property for resale but which are subsequently used or consumed by the vendor. Arizona's use tax rate is five percent.

Arizona Revised Statutes (A.R.S.) § 42-1408.03 provides that motor vehicles and component parts used in any manner for testing or development by motor vehicle manufacturers are

exempt from use tax.

There is no corresponding exemption for test vehicles or motor vehicle component parts under the retail classification. Generally, component parts for motor vehicles may only be sold tax free if the parts are to be resold by the purchaser in the ordinary course of business, i.e., sale for resale. Therefore, because ... is purchasing as a consumer and not a retailer of the motor vehicle component parts at its ..., purchases of the component parts for use in its vehicles at that location from local vendors do not qualify as exempt purchases for resale under the transaction privilege tax.

A.R.S. §§ 42-1310.01.(B)(14) and 42-1409(B)(14) provide that the taxes imposed under the retail classification and the use tax do not apply to the gross proceeds of sales or gross income derived from the sale of machinery or equipment used in research and development. Research and development includes any of the following:

1. Basic research in the sciences and engineering.
2. Applied research in the sciences and engineering.
3. The design, development or testing of prototypes, processes and new products in the sciences and engineering.
4. Research and development of computer software:
 - a. that is embedded in or an integral part of a prototype or a new product referred to in 3 above; or
 - b. that is required for machinery or equipment otherwise exempt under this section to function effectively.

Research and development does not include any of the following:

1. Manufacturing quality control.
2. Routine consumer product testing.
3. Market research.
4. Sales promotion.
5. Sales service.

6. Research in the social sciences or psychology.
7. Computer software research that is not included in research and development as defined above.
8. Other non-technological activities or technical services.

Component parts for exempt prototype motor vehicles used in new product testing at the ... qualify as R&D equipment. The sale of these parts would be exempt under the R&D exemption and may be purchased with the use of a 1316 certificate. Component parts for motor vehicles used in testing at the ... that do not qualify for the R&D exemption are not exempt as R&D equipment and the sale of them to ... by local vendors is subject to transaction privilege tax.

A 1316 certificate may only be used for the purchase of exempt items. The certificate can not be used to purchase all tangible personal property exempt and then allow the purchaser to remit use tax on items that turn out to be taxable. This would be similar to a direct pay permit and would be a misuse of the 1316 certificate. Arizona is a transaction privilege tax state and the liability for transaction privilege tax lies with the vendor, not the purchaser. A vendor and purchaser can not contract the liability between themselves. If items purchased using a 1316 certificate are subsequently used in a taxable manner, ... will be liable for an amount equal to any tax, penalty and interest which the seller would have been required to pay. Furthermore, if the sales price of the items purchased included tax and the items were subsequently used in an exempt manner, ... may apply for a refund from the vendor.

The exemption under the § 42-1408.03 is limited to motor vehicles used for testing or development by manufacturers. Vehicles not used by motor vehicle manufacturers for testing or development are subject to use tax on a monthly basis and applied as a percentage of one thirty-ninth of the dealer net price of the motor vehicles.

Conclusion and ruling:

The following ruling is given based on the facts presented and that the description put forth in your request dated February 5, 1996, accurately reflects the use of the vehicles placed in these classifications.

The department rules that the following are the applicable tax applications for the specifically enumerated vehicle accounting system classifications:

Classification Tax application

1 Antique - historical (ANT) Exempt

- 3 Buy-back (BUY) Taxable at retail, if purchased from Arizona dealer; use tax if out-of-state vendor
- 4 Competitive (COM) Taxable, if purchased in Arizona
- 5 Consigned (CON) Exempt to ...
- 6 Courtesy (CTY) Taxable under use tax
- 8 Damaged in transit (DIT) Exempt
- 11 Emergency (EMG) Taxable
- 13 Senior management program (EVP) Taxable
- 14 Factory and field service (FFS) Taxable
- 15 Facilities/ground support (FGS) Taxable
- 16 Float-unassigned (FLV) Taxable from first calendar month
- 17 ... corporation assignment ... Taxable
- 18 ... directors (...D) Taxable
- 19 ... executives (...E) Taxable
- 20 ... pool (...P) Taxable
- 21 International service personnel (ISP) Taxable
- 22 Lease (LEA) Exempt to ...
- 23 Long term promotion (LTP) Taxable
- 24 Not owned (NOT) Exempt to ...
- 25 Product evaluation - C (PEC) Taxable
- 26 Product evaluation - D (PED) Taxable

- 27 Product evaluation - U (PEU) Taxable
- 29 Pool general purpose (POL) Taxable
- 30 Pool special purpose (POS) Taxable
- 32 Regional Personnel Center (PRP) Taxable
- 33 Rental (REN) Exempt
- 34 Show and exhibit (SHE) Taxable
- 36 Work related travel (marketing) (TRS) Taxable
- 37 Work related travel (TRV) Taxable
- 40 Vehicle recovery program (VRP) Parts to be resold, exempt
- 41 Warehouse (WHS) Exempt
- 42 Work trucks (WRK) Taxable
- 43 Special event (ZZZ) Taxable

The department also rules that component parts for exempt prototype motor vehicles used in new product testing at the ... qualify as R&D equipment. The sale of these parts would be exempt under the R&D exemption and may be purchased with the use of a 1316 certificate. Component parts for other motor vehicles used in testing at the ... are not exempt as R&D equipment and the sale of them to ... by local vendors is subject to transaction privilege tax.

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in your letter of February 5, 1996, in this request for a private taxpayer ruling.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the Department and is valid for a period of four years from date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the Department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different Department position.

